Senior Executives Association

TESTIMONY OF

THE

SENIOR EXECUTIVES ASSOCIATION

BEFORE THE

SENATE GOVERNMENT AFFAIRS COMMITTEE ON S-1527

TO ESTABLISH A NEW CIVIL SERVICE RETIREMENT SYSTEM

GIVEN BY

G. JERRY SHAW
GENERAL COUNSEL

BLAIR CHILDS
EXECUTIVE DIRECTOR

AND

DR. RICHARD STROMBOTNE
CHAIR OF THE SENIOR EXECUTIVES ASSOCIATION TASK FORCE

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P.O. BOX 7610 • BEN FRANKLIN STATION • WASHINGTON, D.C. 20044
202-535-4328

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Mr. Chairman and members of the committee, we thank you for the opportunity to testify on S-1527 to establish a new retirement system for new federal employees who are now covered by Social Security. I am G. Jerry Shaw, General Counsel of the Senior Executives Association (SEA) and I am accompanied by Mr. Blair Childs, Executive Director and Dr. Richard Strombotne, Chair of the SEA Task Force on Retirement Issues.

The SEA is the professional association representing the interests of career federal executives who are responsible for directing all the programs and operations of the Federal Government under the policy guidance of political leadership and the statutory requirements enacted by Congress.

We are vitally interested in the retirement system for new employees for several reasons. First, it is our job to make sure that we attract and retain high quality employees whom we are responsible for managing. Second, we believe it is important for the government that the new system be sufficient to insure continuity of federal operations, as well as insure that citizens of this country are willing to make a career commitment to public service. Third, the new retirement system will directly affect future senior executives and possibly current executives and employees who decide to transfer to the new system, and therefore will affect the ability of the government to attract and retain top notch career managers and executives.

The Senior Executive Service (SES) was established by the Civil Service Reform Act (CSRA) in order to provide a cadre of

career executives who were professionals in their occupation, who would provide continuity in government operations, and who were available to be placed by their agency in positions which the political leadership deemed important. Members of the SES gave up most of their job protections that other government employees retained in the CSRA in order to be judged on their performance and to be rewarded or removed from the SES on the basis of their continued performance.

When the SES was established over 95% of the career executives in government voluntarily entered the system. They did so because they believed there were greater challenges, and they were willing to compete to stay in the SES on the basis of their performance. A bonus and award system was set up to reward these outstanding individuals who excelled at their profession, but the implementation of such a system has been very slow.

A retirement system is an extremely important part of the compensation package which the government must rely on to attract career executives into the SES and to retain them there for the remaining years of their career. Every study made of compensation between career SES members and the private sector shows that they are woefully underpaid for the amount of responsibility and the importance of their duties in comparison to private sector executives at similar levels. In fact, over 50% of the career SES members who voluntarily entered the SES in 1978 have since resigned or retired from the SES. Those who have remained, and those who have entered the SES have done so in large part because of the retirement system currently in place. A new retirement

system which does not have the attractiveness of the current retirement system could be a major disincentive to attracting quality people to the ranks of the career SES. It is imperative that the new system that is in place be sufficient to attract and retain executives who can carry out the complex missions of the Federal Government. We think the outlines of such a system are contained in this legislation, but we emphasize at the outset that without the capital accumulation plan that is contained in this bill, it would not meet the goal of attracting good people.

Before commenting on the specifics of this bill, I want to express our appreciation to Senators Stevens and Roth for their leadership and efforts over the past years to deal with the very complicated issue associated with the design of a new retirement system which is fair to employees and which is seen to be fair by all involved.

OVERALL POSITION ON STEVENS/ROTH BILL

We strongly support the philosophy that the new retirement system should follow the best private sector practice in most respects, with a few exceptions appropriate for a staff retirement system of the nation's largest employer. The GAO report of June 1984 on features of private sector retirement systems is an excellent source of information and evaluation. It is important to note that the Federal Government, as an employer of predominately professional, technical and administrative personnel, is generally competing with the largest companies and organizations in the country for talent, not with the smallest.

We support the overall design of the new retirement system so long as it includes all of the three principal components. It is imperative that Social Security coverage be supplemented by a non-contributory defined benefit plan, and a voluntary tax deferred CAP with one to one employer matching of an employee's contributions up to some limit.

The new retirement system should permit the employee who has devoted a full career of 30 years to public service, and his spouse, to maintain the same standard of living after retirement as they had before retirement. As you know, benefits under Social Security are tilted toward the employee with lower lifetime earnings. That is, the percentage of final pay replaced by annuities under Social Security is much greater for lower paid employees than it is for higher paid employees. By contrast, the current Civil Service Retirement System (CSRS) provides annuities that replace the same percentage of final average pay for both higher paid and lower paid employees having the same age and length of service. As proposed, the defined benefit plan portion is simply added on to the benefits of Social Security. There would be a very large disparity in retirement income at age 62 for the 30 year career high income employee under this proposal without the CAP. For example, the employee with $60,000 final salary would receive 10% of final pay from Social Security while the employee with $30,000 final salary would receive 18% of final salary. Even with the defined benefit portion of the plan added to Social Security, the higher paid career employee would receive only 37% of final pay in pension if the CAP was not in

place. Attached to our testimony is a chart by the Congressional Research Service setting forth relative disparities between the lower paid employee and the higher paid employee utilizing Social Security and the defined benefit plan.

Approximately 90% of private firms utilize what is known as an off-set plan to eliminate part of the Social Security "tilt". They integrate the defined benefit component with Social Security so that replacement rates for lower and higher compensated employees are substantially the same. The current bill does not employ an off-set to compensate for the Social Security "tilt", but instead establishes the CAP to do so. It is absolutely imperative that the CAP proposed in this legislation remain strong or the government will be at a serious disadvantage in competing for higher paid executive, managerial, professional and technical talent. This is particularly true when one considers that the recent HAY study reports that federal employees lag behind their private sector counterparts by about 10% in overall compensation. This disparity is even more severe for executives where it is been found that "total cash compensation would have to be increased 58.4% to equal aggregate private sector total cash compensation". We cannot endorse strongly enough the CAP plan as the only acceptable alternative to not using an off-set to the Social Security "tilt".

SEA strongly opposes the CPI minus 2 COLA adjustment for the defined benefit plan portion of the proposed retirement system. We feel that a full COLA is necessary as an essential part of the compensation system. For a career executive, a substantial

amount of his/her retirement income under the proposed bill would, of necessity, come from investment in the CAP. Since Social Security would make up a very small portion of the replacement rate, the COLA on Social Security would be a very small protection for higher paid executives. Since there would be no cost of living protection on the CAP and if there was a reduced COLA on the defined benefit portion, executives, as well as members of Congress, would have little protection against substantial erosion of their retirement benefits over a normal retirement span.

The people most harmed by a CPI minus 1 or 2, or a percentage of CPI on the defined benefit portion of the plan would be those in the middle and senior levels of government and in the technical positions. This is exactly the area where government has the most difficulty recruiting and retaining employees currently.

The provision for optional, normal retirement at age 55 (or greater) for an employee with ten or more years of service, but less than 30 years of service, with a penalty of 5% per year for each year before age 62, is commendable. It would provide employees with a wider range of choices, at no cost to the government, and we support it.

We recognize that the penalty of 2% per year for each year before age 62 that would apply to normal retirement (or involuntary retirement) conforms with typical private sector practice. Nevertheless, the GAO and other studies point out that some large firms permit retirement at age 55 with no penalty. In order to

encourage long service employees who dedicate their professional lives to the government, we think that an employee who has served his country for 30 years should not be penalized for deciding to retire at age 55 with 30 years service. What is more, the cost of unreduced retirement at age 55 and 30 years of service is relatively small -- 1/2% of payroll. Therefore we recommend that the defined benefit plan retain the provisions of the CSRS with respect to the ability to retire without penalty at 55/30, 60/20, and 62/5.

Next, we believe that provisions of the bill regarding benefits to survivors of employees and annuitants are quite inadequate. Survivor benefits are very important considerations for employees. The availability and level of benefits to survivors in the new system should not be less than in the current CSRS.

Moreover, the provision of the current CSRS for joint and 50% survivor annuity at a cost of 2 1/2% reduction in the first $3600 of annual annuity payments and 10% of annual payments above $3600 should be retained in the new system and used as the basis for any further actuarial adjustment needed for other options. It is a reasonable balance between the individual employee having to completely fund the survivor annuity and the employee having to fund none of it.

We strongly support the one-to-one matching ratio for contributions to the tax deferred CAP which will provide a strong incentive for a high percentage of all new employees to participate. The five percent limit provides these employees with an

opportunity to save for additional retirement benefits as they see their own needs. It is particularly important that the higher paid half of the employees have access to such a plan to compensate for the Social Security "tilt". We advocate permitting a higher percentage of salary be invested in the CAP than the proposed 10%.

Virtually all employee groups in the country potentially have access to some kind of tax deferred retirement savings plan whether it is 403(b), 401(k), 457, a Keogh plan or a defined contribution plan. Indeed, even non-profit organizations can provide 40k(k) or in some instances a 403(b) profit sharing plan for their employees, as the April 29, 1985 issue of Forbes points out. Federal employees are virtually the only major group of employees that have not been included as yet. We recommend that all federal civilian and military employees be provided with the opportunity to contribute to a tax deferred CAP, not limited to the new employees, and that the contribution limit be set at 20% of statutory pay. This change would remove an oversight that has become a gross inequity. Note that we are not recommending any employer matching of an employee's contributions, except in the new retirement system.

In consideration of how the new retirement system is to be administered, it is apparent that the defined benefit component can be viewed as a variation on the current CSRS and that OPM is the appropriate agency to administer it. The new CAP is, or should be, a different matter. We recommend that a separate independent organization be formed to administer the CAP for the

benefit of its participants, that is, current and past employees and annuitants.

In addition, careful attention needs to be given to the appointment authorities and to organizational matters to ensure that the administration is performed objectively, fairly, and without partisan bias.

CONCLUSION

Mr. Chairman, this concludes our prepared testimony. Thank you again for giving us the opportunity to discuss the Stevens/-Roth bill today. We will be happy to work with your staff to develop these recommendations further or to discuss other topics concerning the retirement system for federal employees generally or for senior executives specifically. If you have any questions now, my colleagues and I will be pleased to respond.

FIGURE 1-4.—Backdrop Plan Variations: Comparison of Three Coordination Approaches—Single Worker Age 62 With 30 Years of Service